Conference Call Transcript

16 March 2018

PRE-CLOSE BRIEFING

Stephen Koseff
Good morning everybody. I see some people are still talking there. We are about to start. Dave, are you there? Where is Dave? Who have we got looking after the show there? Right. I'm going to get going now. Welcome to this brief trading update. It's a tradition of ours to do this just before we go into a closed period. If I look at the operating environment over the past year I think that clearly we had quite a lot of uncertainty in our two core geographies with Brexit negotiations and political uncertainty in South Africa. That continued to impact corporate and consumer confidence in the UK.

And then if we go back to South Africa I think the economy was very weak up until recently, although we did grow at 3% in the last quarter. That came a lot from agriculture and off a low base. I think post the ANC elective conference in December with the election of Cyril Ramaphosa as ANC president, and more recently as president of the country, we have seen a significant improvement in the outlook for South Africa. That obviously wouldn't have come through yet for the full financial year, but we are starting to see the move uplift. In fact I was just at an engagement with the president, the ministers and a whole host of CEOs on a new initiative in South Africa called the CEO Initiative and a project called the Youth Employment Service. And if you just compare the mood to the mood six months ago or four months ago, we're in a different country. So I do think that the South African economy will start gaining traction. And there are a lot of initiatives and a lot of commitment from government and from business, and hopefully from labour, to create that social compact that is needed in society.

I think on the stock market front obviously we had a very strong Dow. The South African stock market also performed quite well over the year. It was quite mixed as to where the performance came from. And more recently South Africa Inc. shares have had a strong run while the UK stock market generally was relatively flat if you look at the FTSE 350 or the FTSE All Share. If you look at our expectations for this financial year I think the asset management and wealth management divisions are expected to report results ahead of the prior year. They both benefited from higher levels of average funds under management and strong inflows. We believe the global specialist bank will report results behind the prior year, a similar trend to what you saw at September. The South African specialist bank marginally ahead of the prior year and the UK specialist bank will be well behind the prior year. And we did give you some colour on that in December.

I think the appreciation of the Rand against the Sterling would have had a positive impact on our results. But we do expect our revenue to be ahead of the prior year. Recurring income as a percentage of total operating income is about 76%. Our expenses will still grow marginally ahead of revenue because there is a lot of investment taking place in growing our client franchise businesses and our infrastructure. And we are as you are aware moving to new premises in London, so we've got double rent. We launched that Click & Invest in the wealth business. That costs money. And there are a lot of regulatory projects. So overall we expect the operating profit – the pre-tax number – to be in line with the prior year.

So if we look at our core earnings drivers I think third party assets under management at the end of Feb had increased by 9.1% to £164.5 billion. That was 8% on a currency neutral basis. On the balance sheet the currency is having very little effect. Loans and advances about 11.7% to £25.4 billion. That is about 9.5% on a currency neutral basis. And customer accounts 5.5% to £30.7 billion, 3.4% on a currency neutral basis. I think on the balance sheet we have remained very liquid. We have also used the opportunity to try and bring cost of money down by changing the relationship between deposits and loans. So it has gone from 76% to 81% in this particular period.

On the capital front Investec Ltd is just slightly below the 10% target. There is a chance to get there, but it is slightly below. And Investec Plc is well ahead of the target. We have taken a decision as a stepping stone towards AIRB to implement a foundation based approach in South Africa in the 2019 financial year. This is still subject to regulatory approval. Once we have implemented IRB we will then follow on with the implementation of AIRB. Both will have a positive effect on our capital ratios. But obviously AIRB has a much more positive effect. We have still got very good leverage ratios and as you are all aware we are not a very highly leveraged institution. That is the nature of our business.

I think on impairments we've taken the decision on certain legacy assets to increase impairments as we have certain exit strategies for some of those assets, an acceleration of the exit strategies. But overall the impairments in the legacy portfolio as a consequence will be higher than last year. And the impairments in South Africa and the ongoing business are a little bit ahead of the prior year but still at the lower end of our long-term range of 30 basis points. So overall we expect the credit loss ratio to be between 0.6% and 0.65%. Last year it was 0.54%. That is fundamentally from an increased provisioning in the legacy portfolio. So if we look at the legacy portfolio we expect it to be at the end of March about £350 million coming from its peak of £4.8 billion in March 2008. So I think it's nearly done. And as I said before this is the last year we will be showing legacy separately. From next year we also introduce IFRS 9 so you will categorise legacy between stage one, two and three. Most of it will be stage two and stage three.

If we look at our divisions, asset management funds under management are up 11.1% to just under £106 billion. Strong net inflows of £4.2 billion up to the end of Feb. and I think earnings growth supported by decent market levels and inflows. Again similar to what we had the first half, lower performance fees in South Africa. That was a first half phenomena. But the underlying annuity businesses have continued to grow. And I think we've got pretty good momentum supported by competitive investment performance. So this business has come a long way. If you go back to 2007 when it managed £25 billion it now manages £106 billion.

Our wealth and investment business' overall performance of the global business is expected to be ahead of the prior year. We have higher average funds under management. We've had net inflows of about £1.8 billion up to the end of Feb. I think positive impact of the growth in funds under management in South Africa would be reduced by the Rand strength because some of our clients have what we call either asset swaps or use their offshore allowances. And that would generate less revenue. In the first part of the year there were lower levels of activity. I think in this last quarter we have seen quite a big shift as confidence has come back into the South African business. Costs are expected to be ahead of the prior year impacted by, as I mentioned earlier, the launch of Click & Invest during the year and obviously all the regulatory projects, BEPR and in particular MiFID II which actually went quite well in our group but has still cost money. I think overall funds under management up 5.8% to just under £58 billion.

On the specialist bank just to give you some colour, as I said earlier results are expected to be behind the prior year. Net interest income is up, supported by book growth of 11.7%. We have seen good growth in net interest income in the UK and also reduced our cost of funds. In South Africa our net interest income is pretty much similar to the prior period as we saw our book growth was offset by roll off of some high-yielding debt securities. I think if we look at investments, associates, trading and other operating income, investment income is behind the prior year while associate income through our associate investment, Investec Equity Partners, is well ahead of the prior year. And trading income is expected to be behind the prior year. That is again a first half phenomenon.

There was a lot of activity when Brexit was announced as there was a lot of volatility. That has disappeared. But there are still good customer flows, but slightly lower levels of activity. We did announce sometime in December that we would take certain losses on the collapse of the Steinhoff share mainly in our trading business as a consequence of not being able to hedge certain derivatives when we shed those from 46 to ten. Overnight you can’t get yourself delta neutral, for those who understand what I’m talking about. So we expect the loss to be a lot less than we originally estimated, but it will still have a negative impact on revenue in this particular period.

On fees and commissions I think we had good performance from the South African banking structuring businesses. As we mentioned in September UK corporate fees were impacted by less investment banking activity off the back of a strong prior year. So we expect in South Africa up, UK a little bit down. And then costs are expected to increase as we continue to invest in infrastructure, head count and our franchise. And obviously we’ve got the build-up of the UK private client offering. And then we also have the double premises which impact mainly this business because this is a business that is actually moving. The other two, asset and wealth, stay where they are.

If we look at additional information the effective tax rate will be particularly low as impacted by release of provisions in South Africa no longer required as a consequence of either settlements or winning court cases. And then net controlling interests, £82 million, that’s asset management and the consolidation of the property fund. And we expect about 923 million shares to be in issue on average. So overall I think the operating performance from our point of view in toughish periods for part of the year was satisfactory. The backdrop was quite challenging. The UK economy although it’s growing is influenced by the complexities of Brexit. But as I mentioned South Africa is moving into a very different space. But it wasn’t a pleasant place to be building up to that elective conference because the outcome was very binary. But I do believe now that is behind us.

As I said earlier I was just with the president. He understands large business. He understands bringing in investment. He understands engaging with business in a proper manner, having dialogue that can actually make a big difference to the country. So getting into a much more positive space in South Africa. And I’m sure on the land issue which he talked about again today this will be a process, not an event. And there will be a lot of care taken in terms of trying to address issues of history but at the same time not trying to mess up the economy.

So I think the fundamentals of the group have continued, the trends seen in the first half of the year. Performance underpinned by growth in our key earnings drivers and a solid income base. So we as an organisation have continued to invest across our client franchise businesses, ensuring that we remain competitive – it is a competitive industry and a competitive environment – and relevant in the markets in which we operate. That is just a brief outline of life for us. And we just obviously announced succession. It has gone particularly well both internally and externally. And we are very positive on the future of this organisation. So that's the end of the story. I can now take questions. I see Hannah is smiling. Have you got a question or must I go to London first? I will go to London first. No nasty headlines, Hannah. Here we go.

Dave [?]
Good morning Stephen. Good morning from the audience here. Can I ask anyone questions or give us questions?

Stephen Koseff
First out the blocks.

Male speaker
Could you comment on some of the moving parts within the net interest margin, clearly a reduction in excess of [unclear]? You mentioned cheap deposits. I suspect asset yields have probably come down as such as well. Could you give us a guidance on the moving parts within it?

Stephen Koseff
Look, as we said I think we've had good growth in the UK net interest income. In South Africa we had some of the impact that you talk about, good growth in loans and advances offset by a roll off of certain assets that were quite decent yielding. But overall growth in net interest income. But if you want detail we're going to give you detail in May.

Male speaker
Guidance on the margin rather than the actual amount of interest income itself.

Stephen Koseff
I'm looking at Ursula. It's not materially different overall from what you saw in September. I know you've got to put it into your model. Malik, I can see you half smiling.

Dave [?]
Stephen, no more.

Stephen Koseff
Okay. We're coming to SA. Hannah, you're not going to ask me a question? Oh no, offline, hey. No more questions? Ja.

Male speaker
[Inaudible segment].

Stephen Koseff
No, it's still small. The main businesses are still South Africa, the UK. We've got a decent sized operation in Ireland and we've got the platform in Switzerland. But Hong Kong is still very small. Anything else? Okay. Thanks very much and enjoy your day or your weekend. Thank you.

END OF TRANSCRIPT